

# Property Tax Incidence in Utah

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Prepared by the Office of Legislative Research and General Counsel for:

Revenue and Taxation Interim Committee  
Utah State Legislature

September 17, 2008

# Presentation Outline

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- Introduction to Tax Incidence
- Literature Review
- Utah Property Tax Incidence

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# Property Tax

## Theoretical Background

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<b>Tax</b>	<b>Theory</b>	<b>Actuality</b>
<b>Sales / use</b>	Consumption	Certain consumption (many services excluded from taxation) and certain production (many business inputs are taxed)
<b>Income</b>	Income	Certain income (only certain income recognized for tax purposes, only income in excess of deductions and value of credits is actually taxed)
<b>Property</b>	Asset wealth	Certain property (intangible types of asset wealth such as money and stocks excluded, only 55% of residential value taxed, household personal property generally excluded, agricultural property at production value)

# Who *REALLY* Pays Taxes?

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- The person who “writes the check” may or may not bear the ultimate economic burden of the tax
  - Statutory / legal incidence v. economic incidence
- The ultimate burden of a tax may be shifted to someone else by the entity that writes the check
- “Businesses don’t pay taxes – People do”....the million dollar question is, which people?
  - Business owners in the form of lower investment returns
  - Employees in the form of lower wages
  - Consumers in the form of higher prices
  - In-state / out-of-state (exporting the tax)
- Example 1: Sales Tax on Food (such as produce)
  - Although businesses “pay taxes” in terms of collecting the funds and “writing the check”, the business selling produce likely does not ultimately bear the burden of the sales tax. That burden is likely borne by the consumer.
- Example 2: Employer Portion of Federal FICA Taxes
  - Although an employer “pays the tax” by remitting FICA taxes to the federal government, it is widely assumed in economic literature that the employee bears the ultimate burden not only of the employee portion, but also the employer portion of federal FICA taxes (in the form of lower wages).

# Who *REALLY* Pays Taxes?

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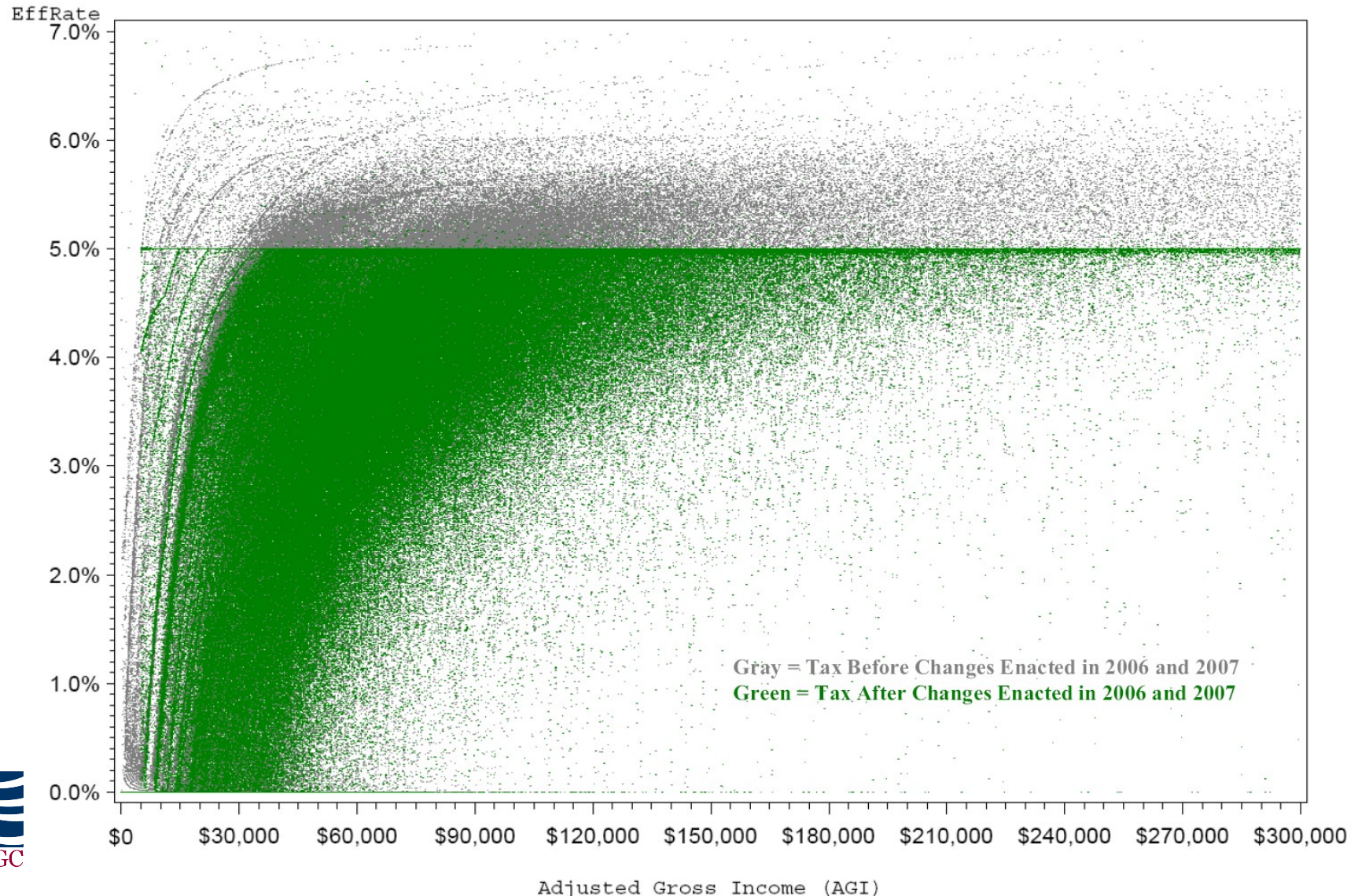
- The ultimate burden is affected by the responsiveness of supply and demand to changes in prices caused by changes in taxes
  - Example 3: Land Value Tax
    - Property tax based on only the value of land, not buildings and other improvements
    - Many economists view this as an ideal tax because the supply of land is (basically) fixed
    - Because the supply of land is (basically) fixed, there is (generally) no change in the supply of land in response to changes in the tax
    - This has important implications for economic efficiency - It minimizes the economic distortions that occur due to the tax

# Tax Incidence Terminology

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- When compared to income...
  - A **Proportional Tax** is a tax which takes the same percentage of income from a low-income household as a high-income household
  - A **Progressive Tax** is a tax which takes a smaller percentage of income from a low-income household than from a high-income household
  - A **Regressive Tax** is a tax which takes a larger percentage of income from a low-income household than from a high-income household
- One way to visualize this is to chart the **effective tax rate** across income levels
  - Effective tax rate (or average tax rate) calculated by divided the amount of a particular tax by some measure of income
    - $\$1,000 \text{ tax} / \$50,000 \text{ income} = 2\% \text{ effective tax rate}$

# Utah's New Income Tax System is Progressive Overall





# Utah's New Income Tax System

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- The newly enacted income tax system is a progressive system overall with respect to AGI
  - Effective rates generally increase as income increases
- The system is not a proportional system overall, even with a single statutory tax rate of 5.0%
  - However, the tax is proportional in two ranges
    - Proportional 0% tax rate at lower income levels
    - Proportional 5% tax rate at higher income levels
- A tax can be made progressive, regressive, or proportional through the tax BASE as well as the tax RATE

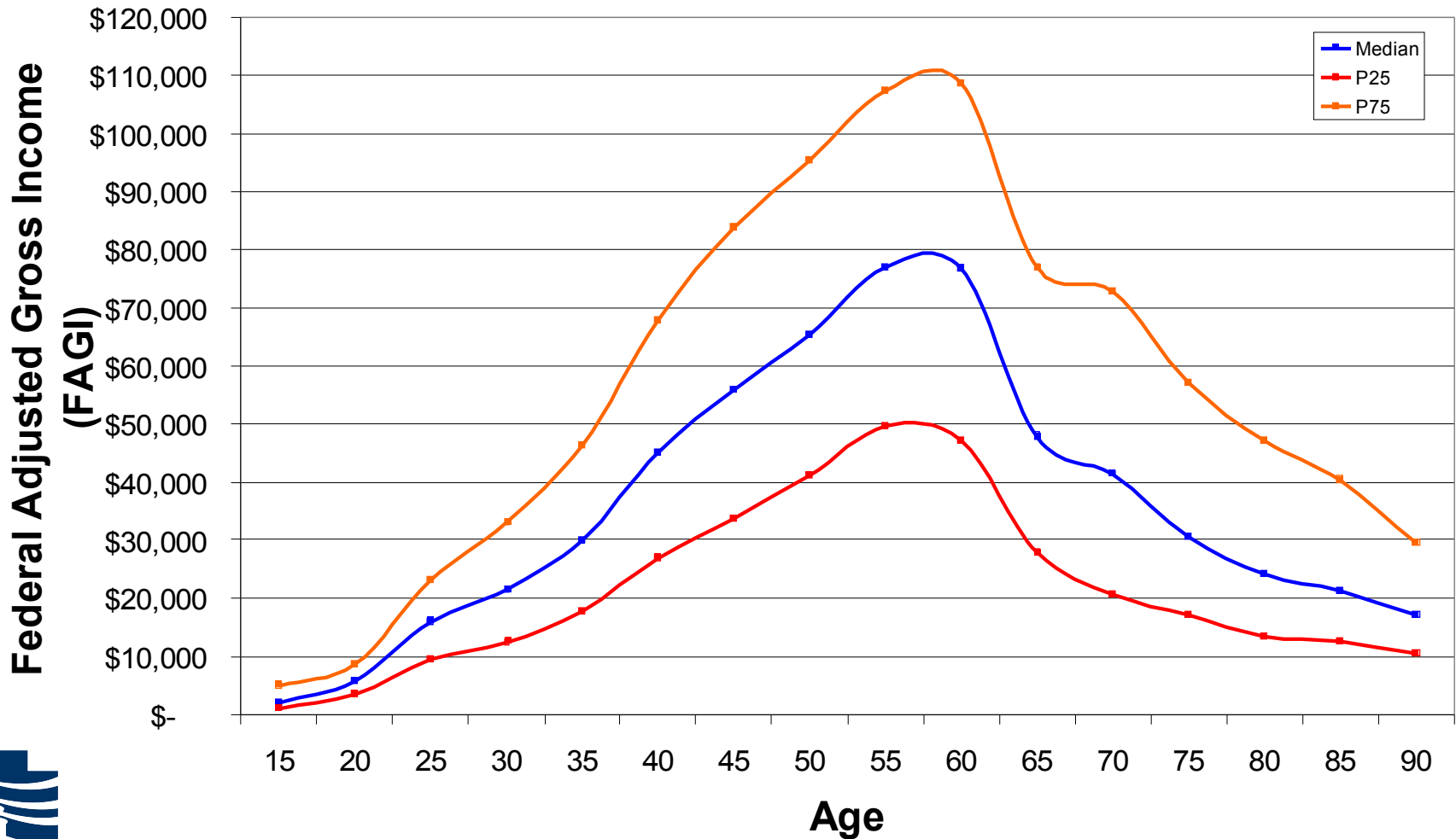
# Measures of Income

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- Different measures of income
  - True economic income – difficult in practice to identify
  - Tax return measures
    - Federal Adjusted Gross Income (FAGI)
    - All income reported on a tax return (federal total income + non-taxable income)
  - Census definition of income
- Income is not a perfect measure of economic well-being
- Lifetime v. annual income
  - Consumption and investment decisions (especially property purchases) are often made with a time horizon longer than one year
    - Especially relevant to consider this issue with analyzing very low income (and negative income) households
  - Lifetime income data difficult to come by
  - Economic literature generally concludes that over a lifetime, regressive taxes tend to be somewhat less regressive and progressive taxes somewhat less progressive than when current income is used
  - Despite shortcomings in current income as measure of economic well-being, taxes are paid on an annual basis (or more frequently), not over a lifetime, so there is value in comparing current income with current tax

# Lifetime Incidence

## Life Cycle of Income



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# Economic Incidence of Property Tax

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- “Determining the economic incidence of taxes is one the most difficult problems in public finance, and the property tax is no exception. Indeed, the debate over the incidence of the residential property tax has raged for at least the last thirty years, and is still far from resolved”
  - George Zodrow
- “Whether the property tax takes a higher percentage of income from poorer households than from wealthier ones turns out to be a remarkably complex inquiry.... incomplete, imprecise, or conflicting data – that is, most data – will not permit definitive results, and evolving theoretical perspectives may challenge earlier conclusions even when underlying information is unchanged.”
  - Joan Youngman
- A substantial body of economic literature exists on the property tax. Today, the main disagreement among public finance economists appears to be between those who espouse the “benefit tax” view and the “capital tax” view

# Public Finance Literature

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- “Traditional” view
  - Property tax burden borne by consumers
- Benefit tax
  - Property tax is a non-distortionary user fee
  - How closely do the benefits of government services funded with the property tax correlate to the amount of property tax paid?
- Capital tax
  - Property tax burden borne by all capital holders
  - Property tax distorts economic decisions by increasing capital investment in low-tax areas and decreasing capital investment in high-tax areas
    - National average tax burden (“profits tax” component) borne by all capital owners, including homeowners, businesses, and investors
    - Local property tax rates above or below the national average (“excise tax” component) are borne locally through changes in land rent, wages, or housing prices
  - Is owning a primary residence consumption or capital investment (or a portion of both)?
    - Some different considerations in purchasing an investment home and owner-occupied home

# Property Tax Incidence

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- Today, many public finance economists believe that the property tax is a progressive (or at least proportional) tax overall
  - “Economists generally reject a blanket characterization of the property tax as regressive”
    - » Youngman
  - “Because the primary effect of nationwide use of the property tax is a reduction in after-tax returns to capital owners, it is a highly progressive tax. Nevertheless, from the perspective of a single taxing jurisdiction, the local tax is not born by capital owners as a whole but rather by local residents and is a roughly proportional tax.”
    - » Zodrow
  - “Housing expenditures turn out to be more responsive to changes in permanent income than to changes in annual income...unfortunately, analyses based on annual income, which suggest that the tax is regressive, have tended to dominate public discussions of the tax.”
    - » Rosen

# Presentation Outline

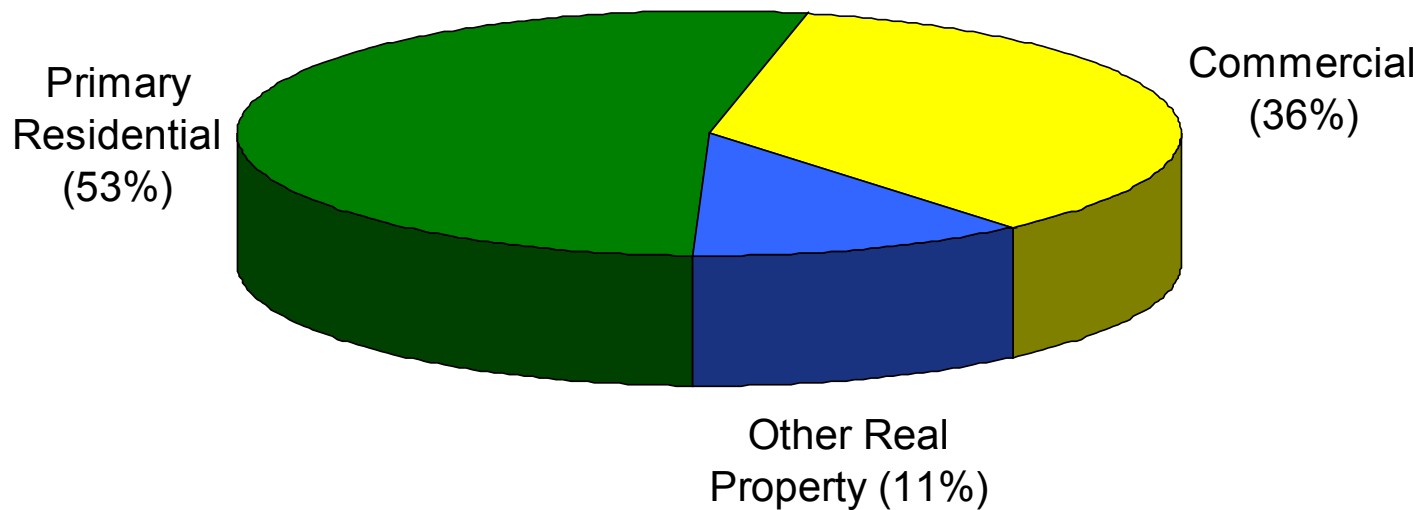
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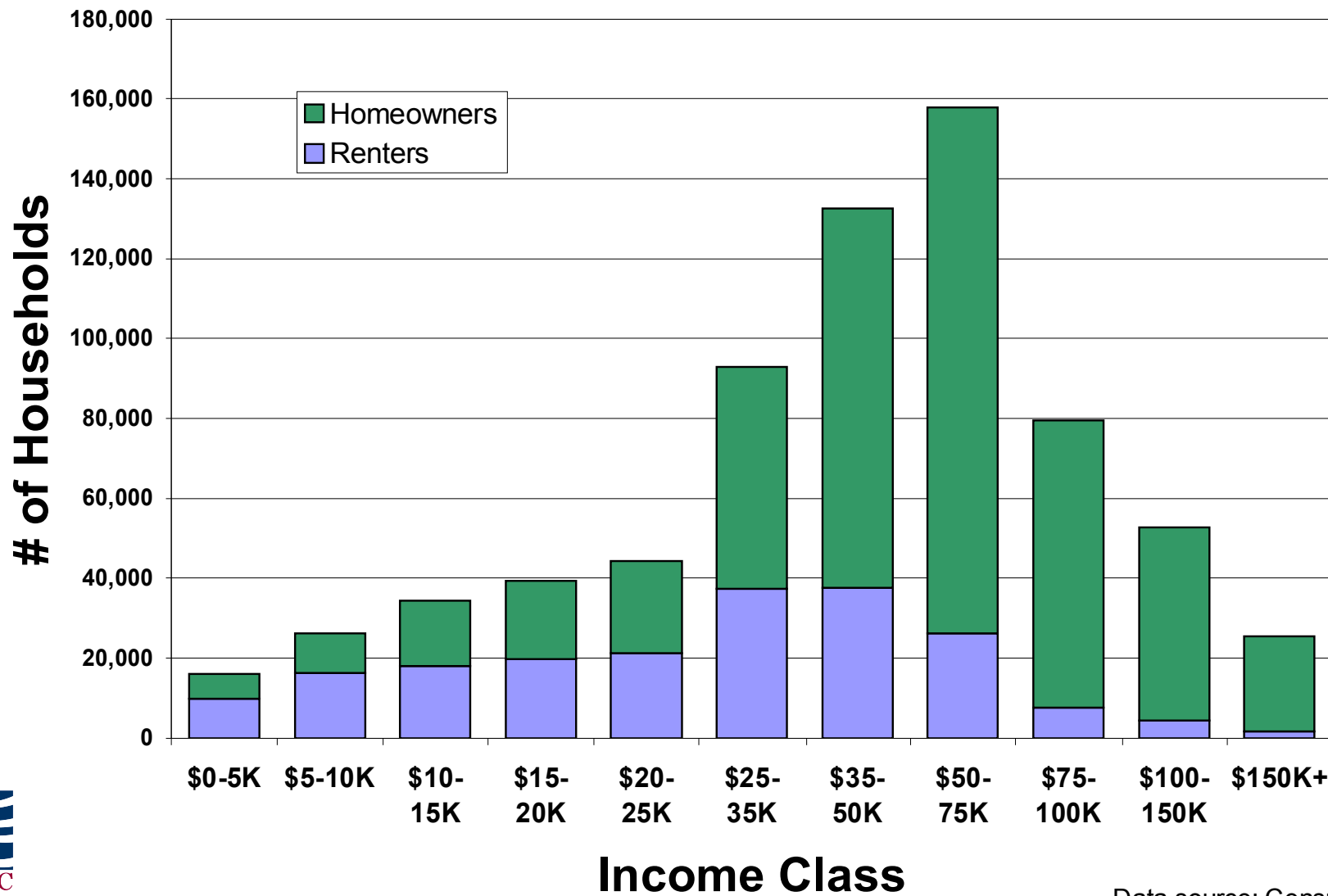


# Property Tax Types

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# Utah Homeownership by Income Class



# Residential Property Tax Analysis

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- General Limitations of Study
  - Imperfect data
  - Based on current income, so may overstate impacts because housing decisions are generally long-term decisions
  - Tax year 2006
- Analyze direct initial household burdens using three methods
  - Link county property tax data with state income tax data
  - ZIP code median
  - Itemized property tax for income tax itemizers
- Each method has its own strengths and weaknesses

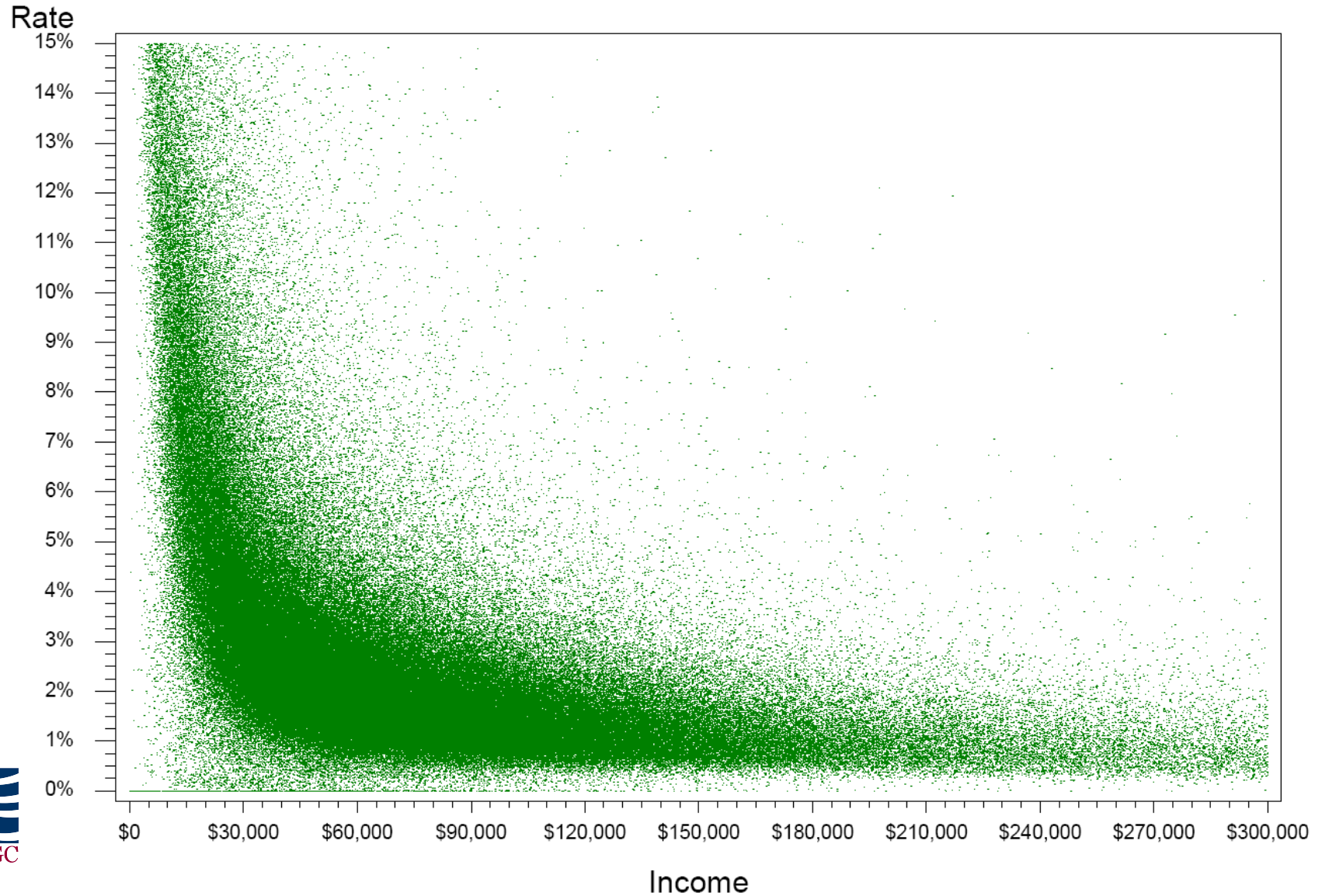
# Residential Property Tax Analysis – Individual-Level Linked Data

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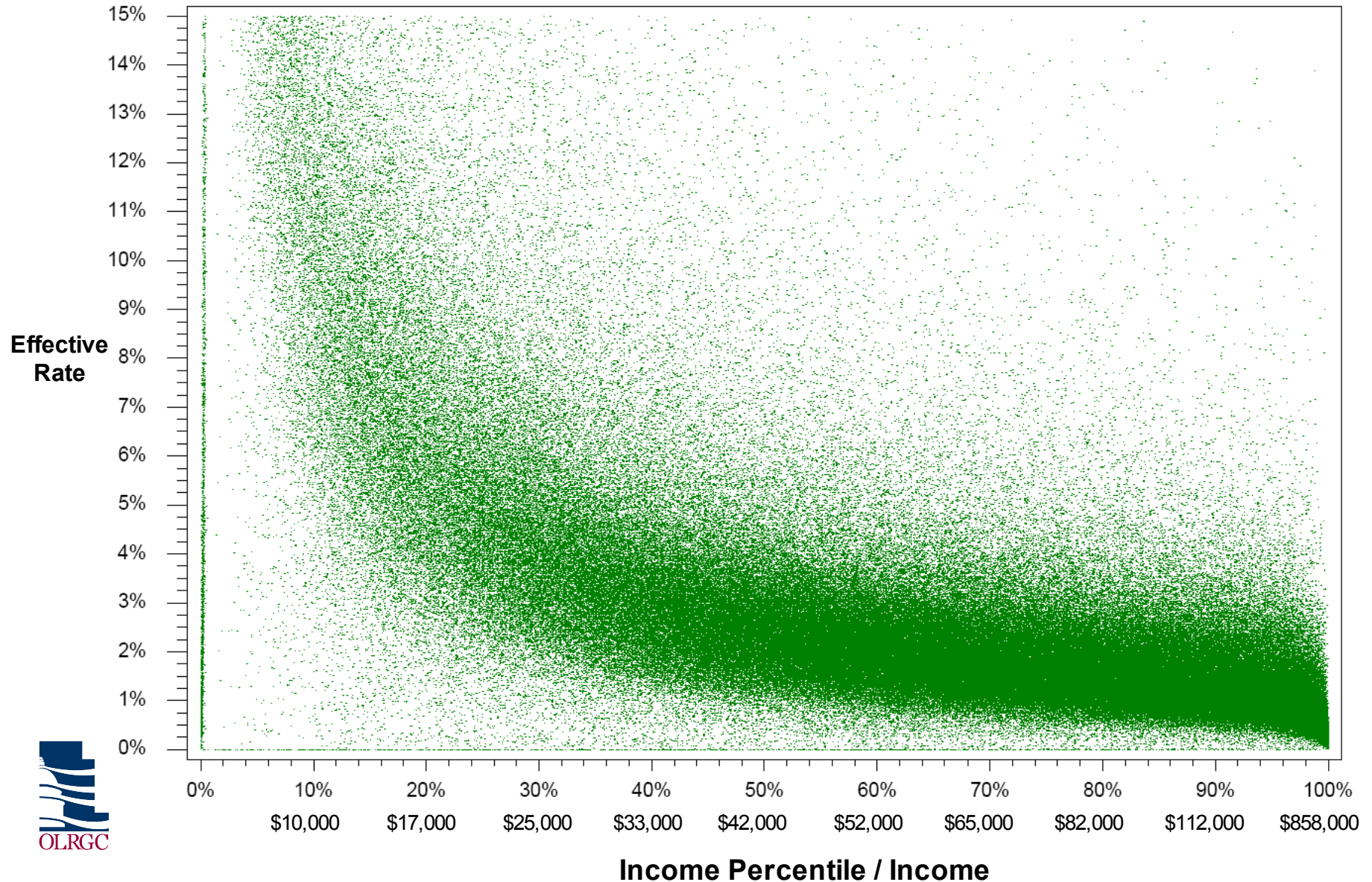
- Methodology
  - Gather tax year 2006 data from every county
  - Compile into a statewide property tax data set
  - Match and merge with individual income tax records using name and address
- Matching successful
  - Roughly 2/3 match rate on residential properties
  - Higher match rate at higher income levels due to higher homeownership rates
  - But likely provides much better information on lower-income households than data from income tax itemizers because relatively few lower-income households itemize
- Effective rates only for matched residential properties
  - Includes second homes with matches or rental properties held in owner's name rather than business name
  - Excludes rental properties held in a business name or with mailing address that does not match income tax return

# Residential Property Tax Analysis – Individual Linked Data

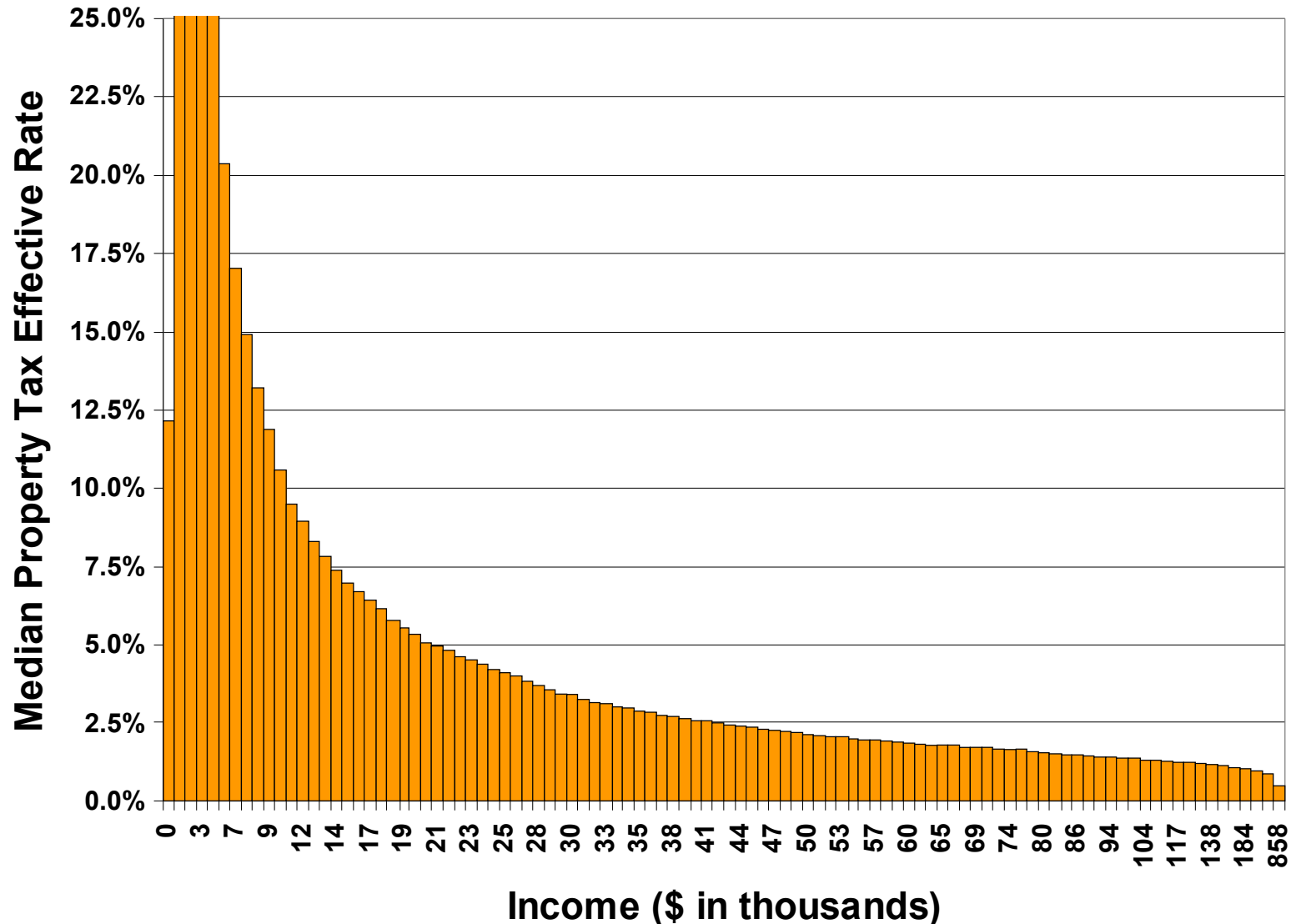
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# Residential Property Tax Analysis – Individual Linked Data

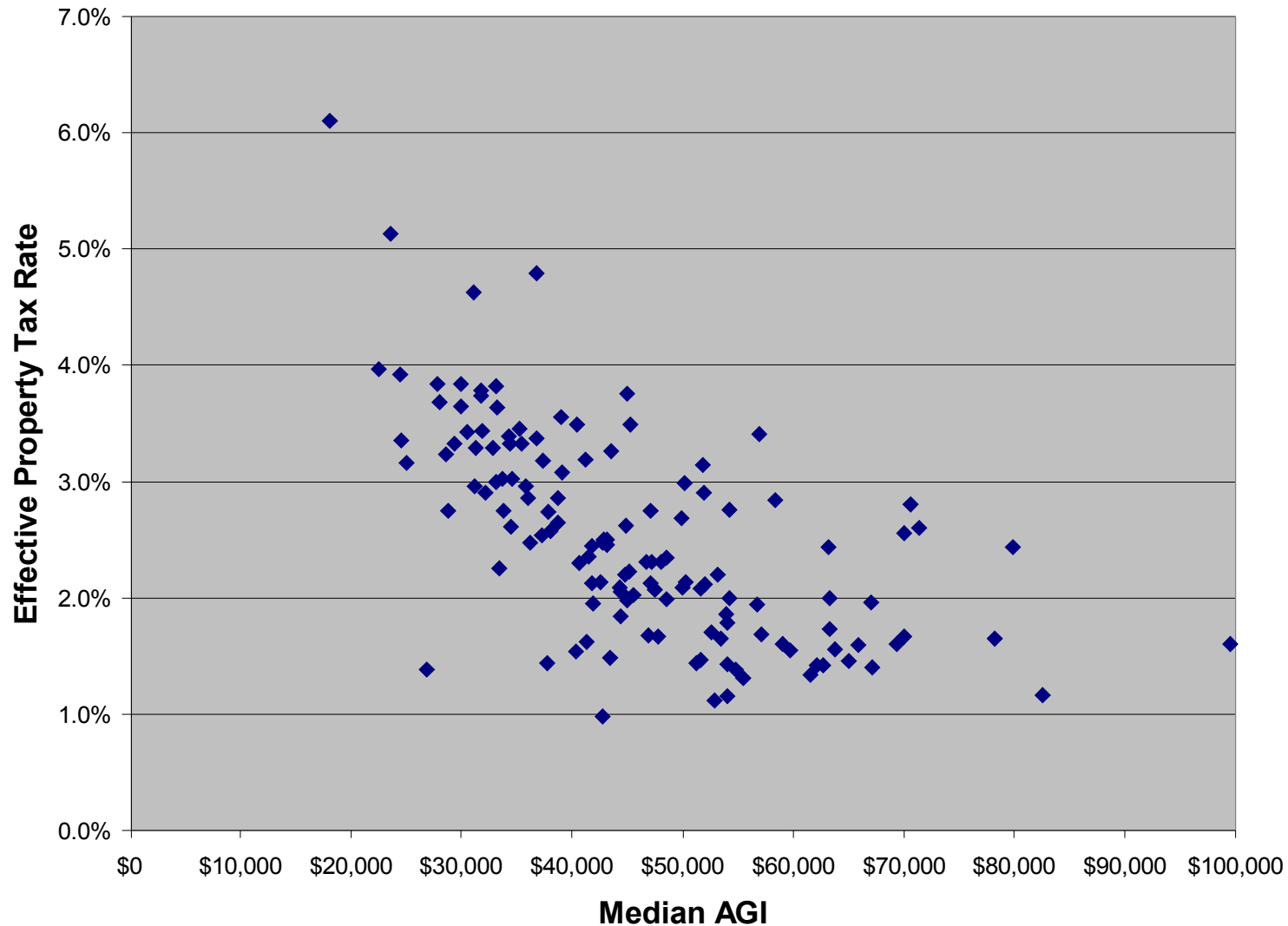


# Residential Property Tax Effective Rates by Income Percentile



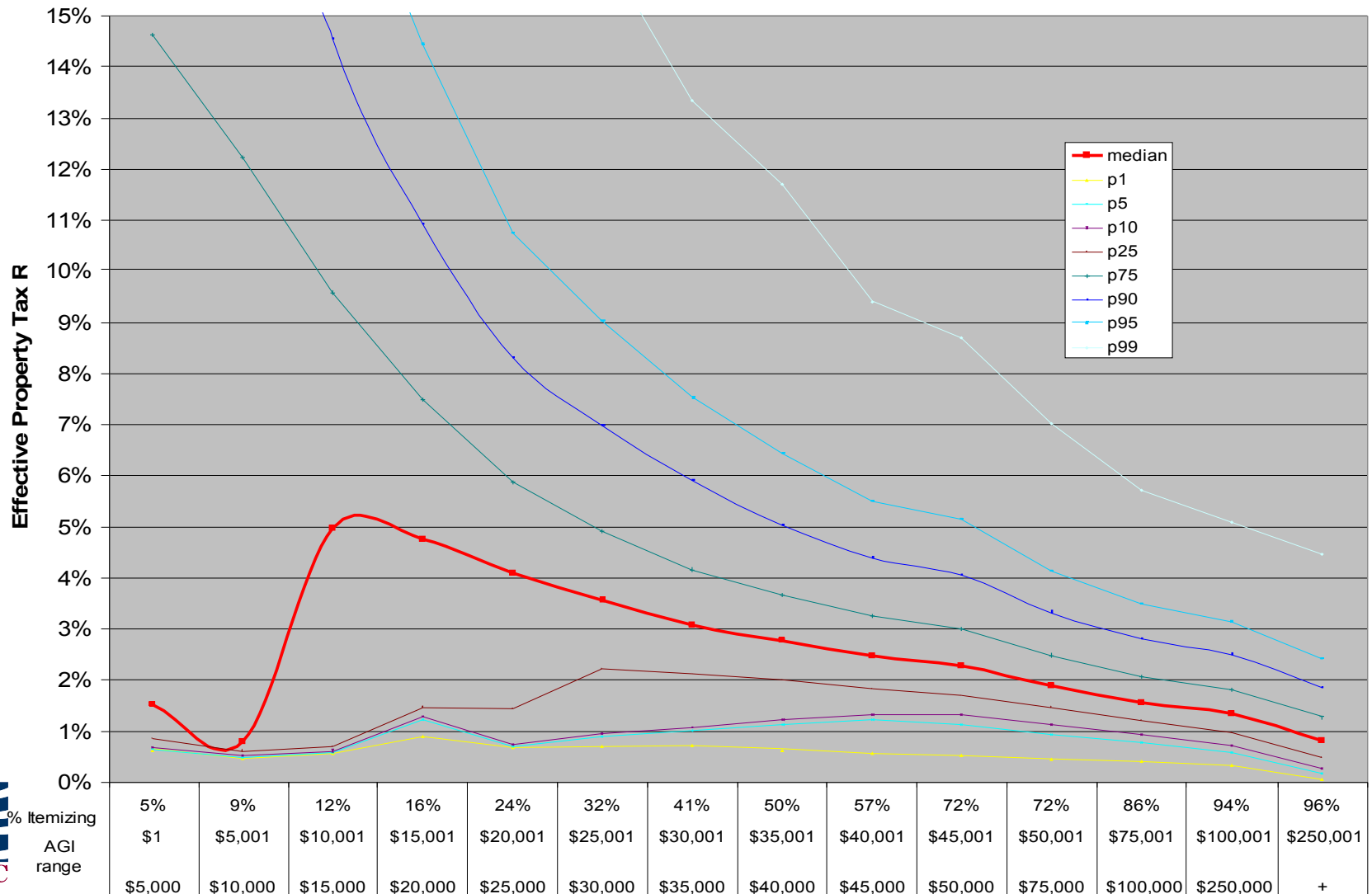
# Residential Property Tax Analysis – ZIP Code Medians

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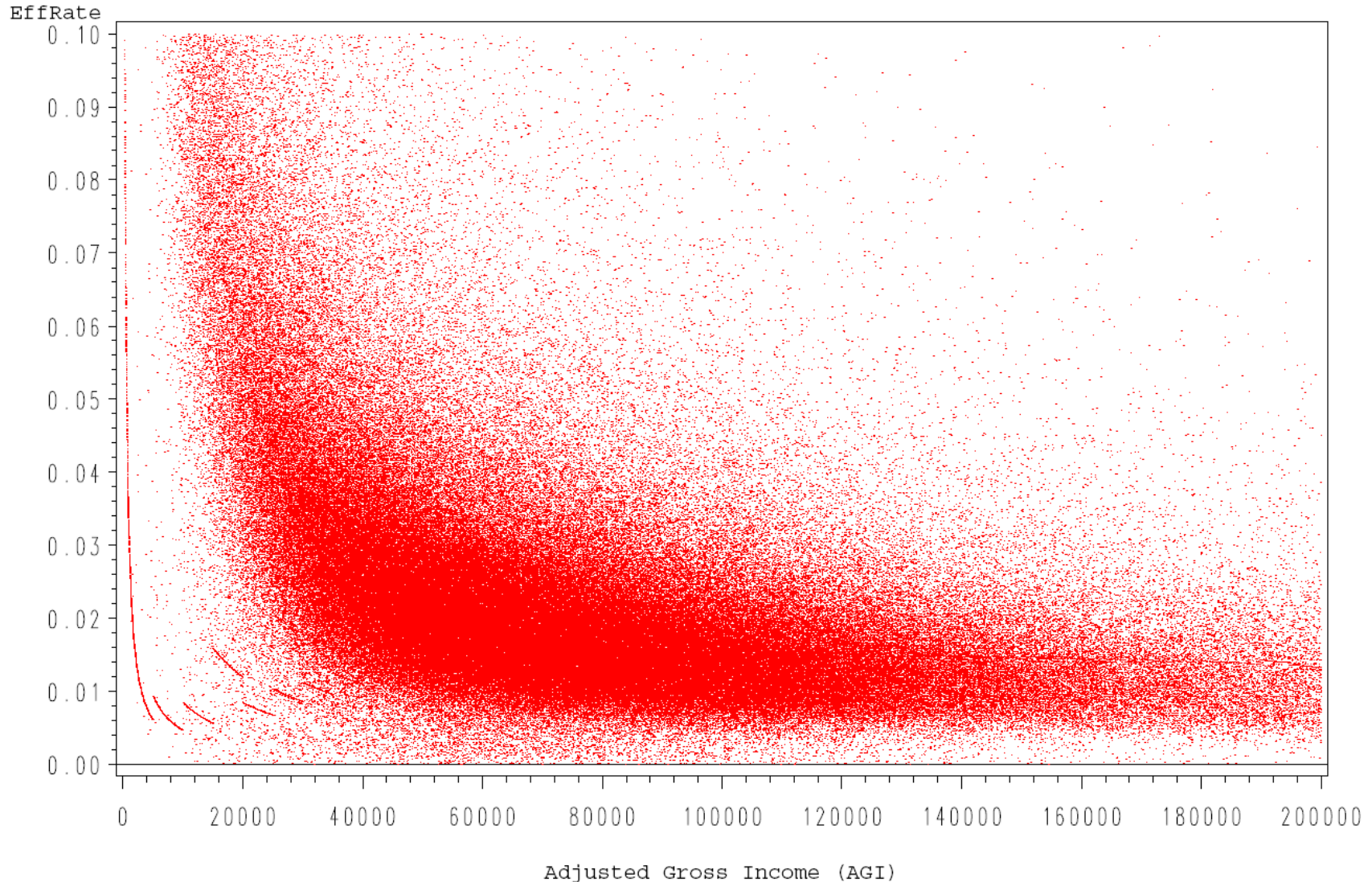




# Residential Property Tax Analysis –Itemized Property Tax



# Residential Property Tax Analysis – Itemized Property Tax



# Property Tax on Rental Properties

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- Initial incidence – property owner “writes the check” for property tax
- Final incidence - are property taxes *really* paid by landlord or renter (or a portion by both)?
- Tax shifting over time
  - If property tax is shifted, the shift may take place over time
    - Rent levels may be sticky on the upside at times
      - Existing lease agreements may lock in a rental price for a set period of time
      - Degree of shifting likely influenced by vacancy levels
        - » A slow rental market (high vacancies) makes the tax harder to shift in the form of higher rents
        - » A tight rental market (low vacancies) makes the tax easier to shift in the form of higher rents

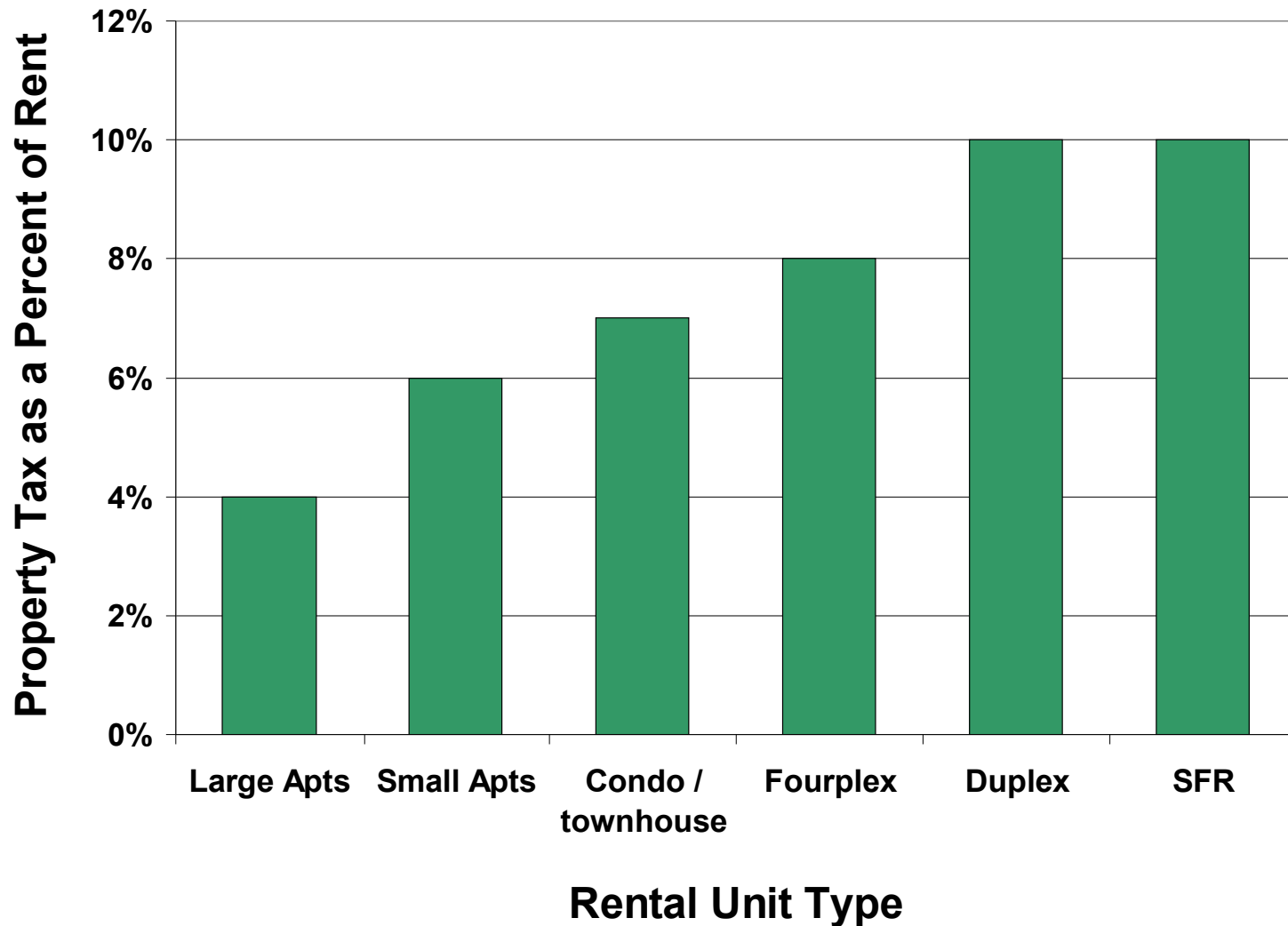
# Property Tax on Rental Properties

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- Methodology
  - Estimate property tax as a percent of rent by collecting rental data and comparing to property tax for that complex
  - Large sample of large apartment complexes (50+ units) across the state
    - Includes more than 35,000 rental units in about 200 large apartment complexes
  - Smaller sample of smaller rental properties in Salt Lake County only
    - Nearly 200 rental units in small apartments, fourplexes, duplexes, single family homes, and condo/townhouses

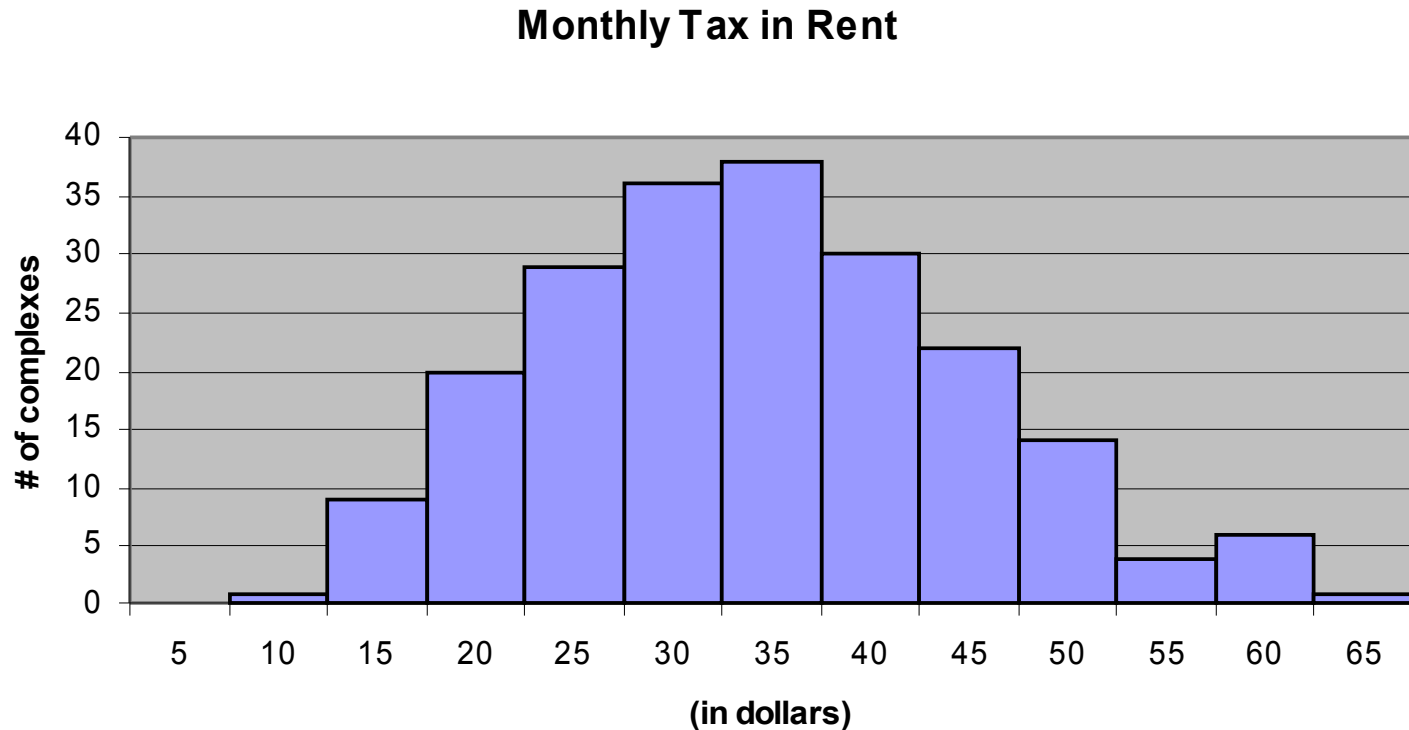
# Property Tax on Rental Units

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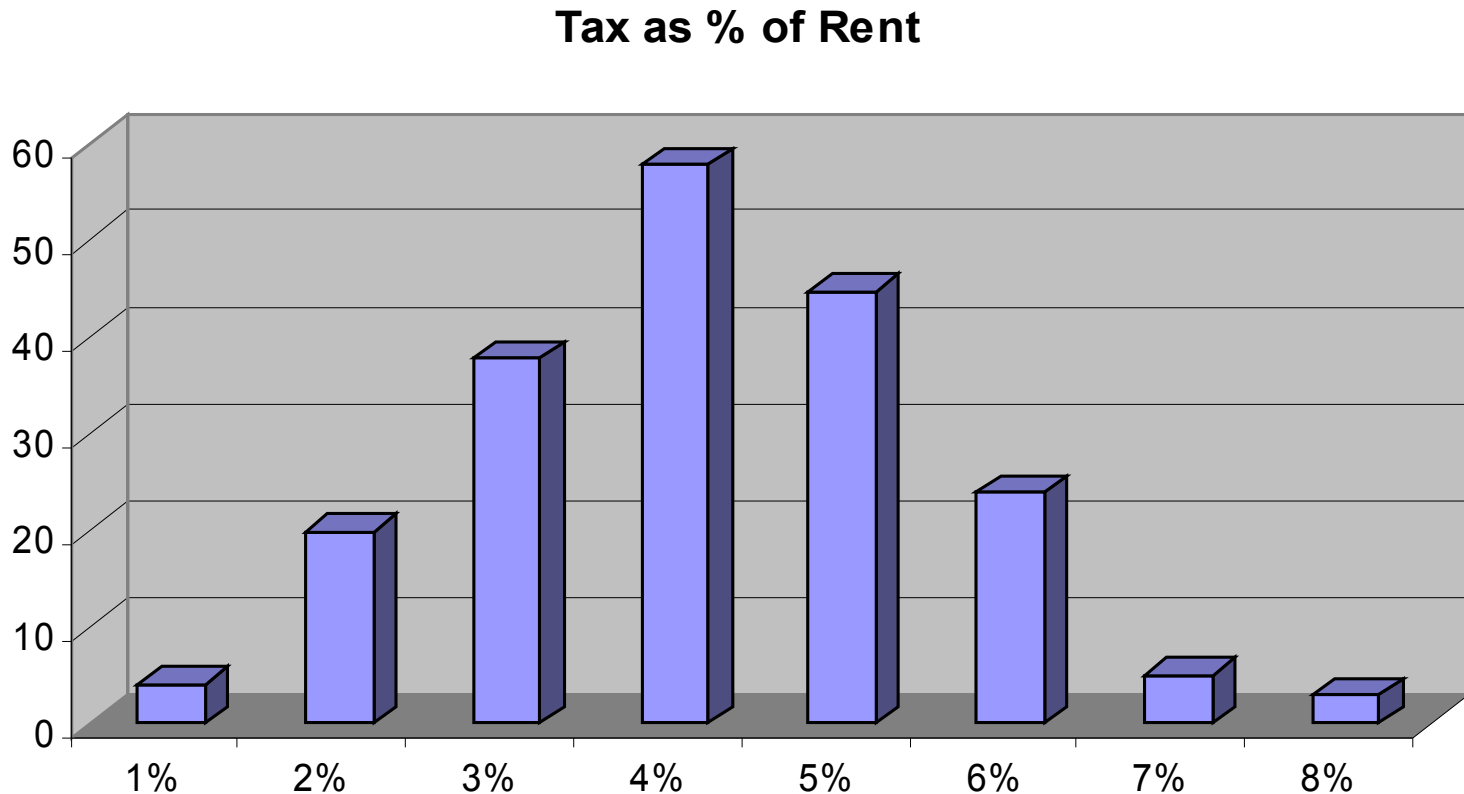
# Property Tax on Large Apartment Complexes (2006)

- Average monthly rent per unit - \$785
- Average tax amount per unit - about \$32 per month or \$380 per year



# Property Tax on Rental Units (Large Apartment Complexes)

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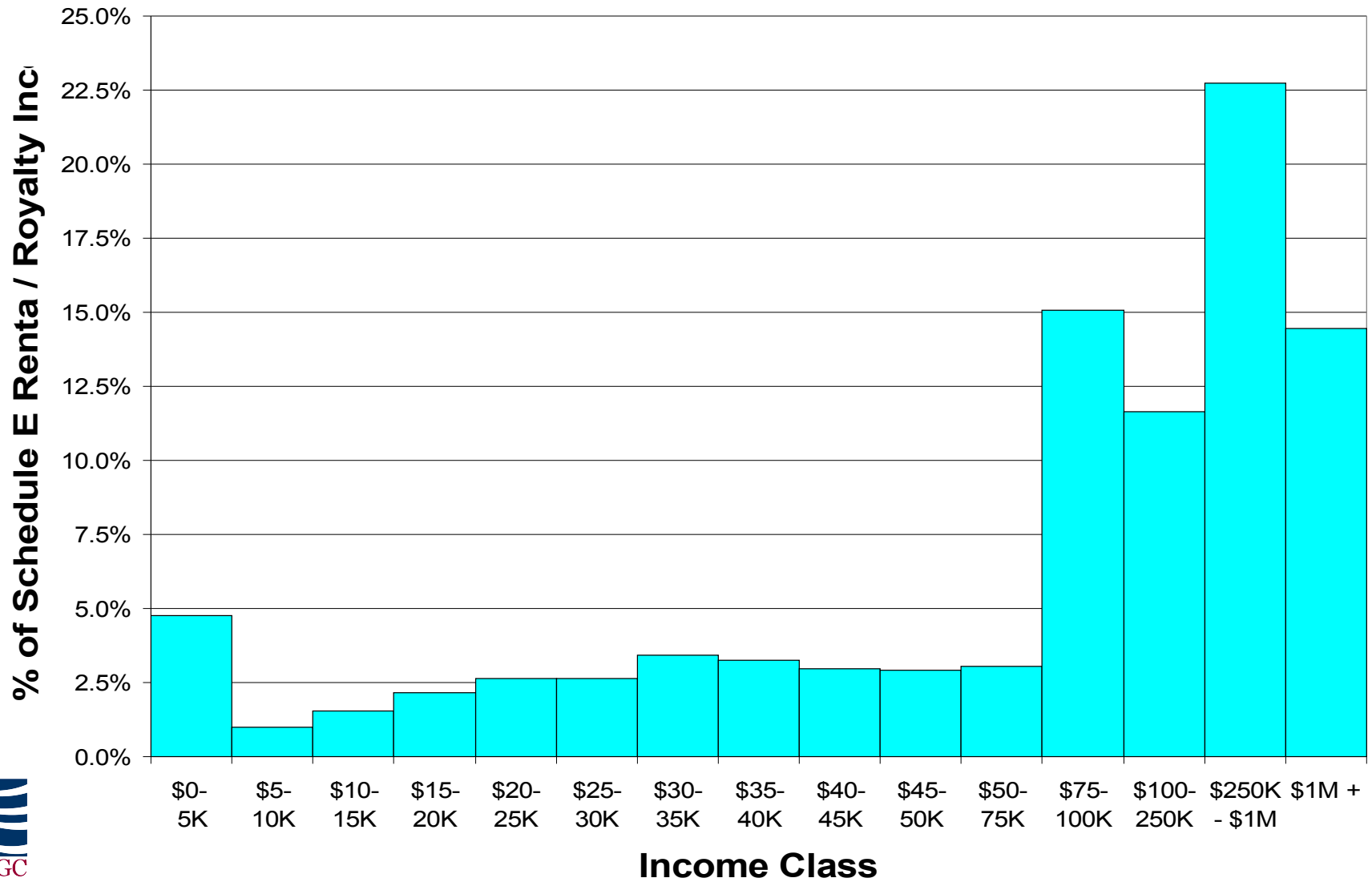
# Distribution of Capital Income

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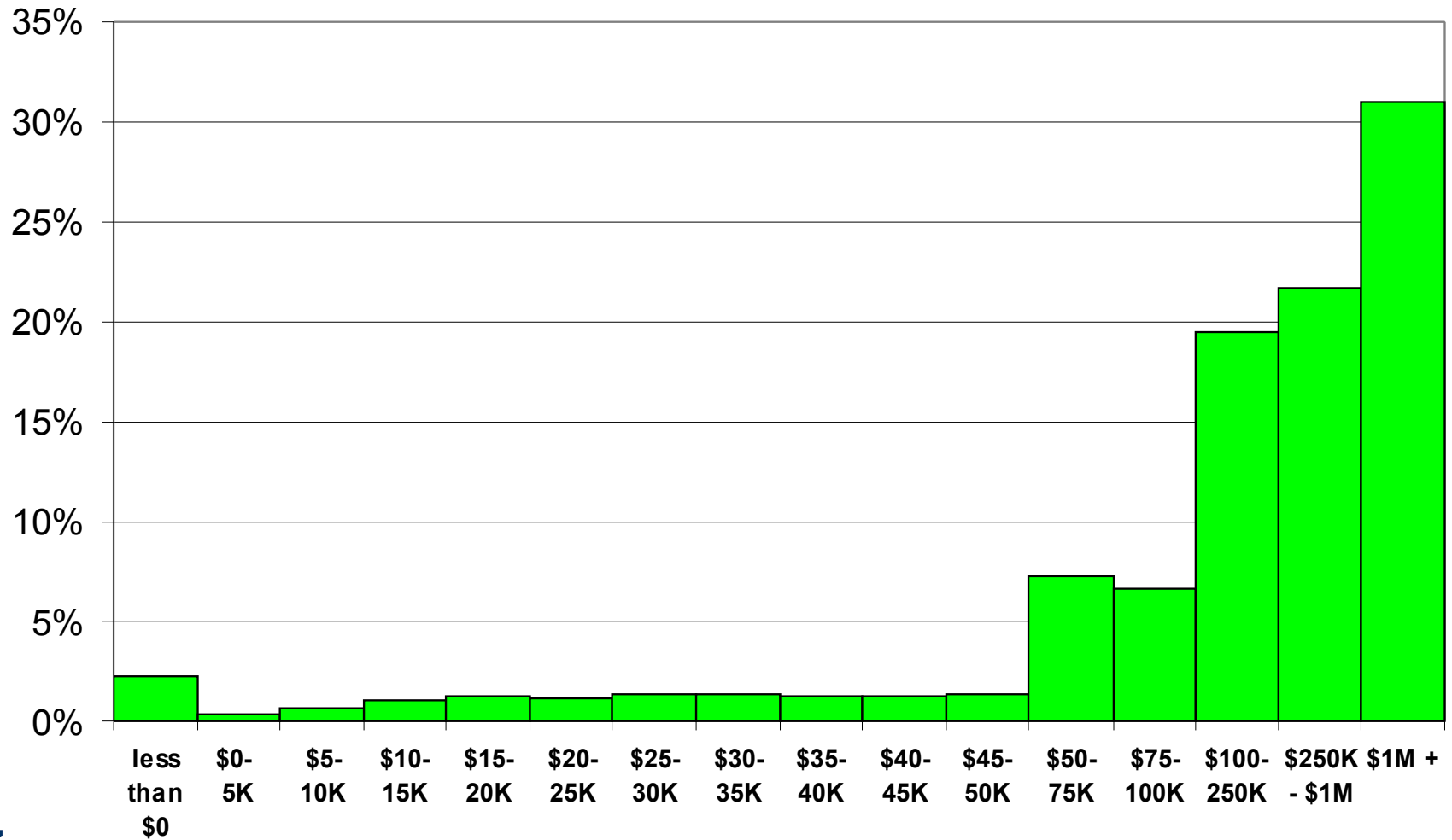
- If ultimate burdens rests on owners of capital, how can we estimate that?
- One proxy for capital ownership is capital income reported on tax returns
- Schedule E rental income a proxy for rental property ownership



# Schedule E Rental Income by AGI Class



# Capital Income Distribution by AGI Class



Please feel free to contact Committee staff  
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